LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
JUL 29 1966
JOHN F. DAVIS, CLERK

No. 396

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

PAULINE W. ACH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF ERNEST M. ACH, DECEASED, PAULINE W. ACH, SOLE LEGATEE, AND PAULINE W. ACH, SURVIVING WIFE,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

H. J. SIEBENTHALER
2300 Central Trust Tower
Cincinnati, Ohio 45202
Attorney for Petitioners

WILLIAM R. SEAMAN

RONALD E. HEINLEN

FROST & JACOBS
2300 Central Trust Tower
Cincinnati, Ohio 45202

July, 1966

THE JOHNSON & HARDIN CO., LAW PRINTERS
CINCINNATI, OHIO

INDEX

	PAGE
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement	3
Specification of Errors to Be Urged	5
Reasons for Granting the Writ	5
Conclusion	10
Appendix A	
Opinion of the Court of Appeals	1a
Appendix B	
Judgment of the Court of Appeals in No. 16,154	10a
Appendix C	
Judgment of the Court of Appeals in No. 16,155	11a
Appendix D	
Judgment of the Court of Appeals in No. 16,156	12a
Appendix E	
Judgment of the Court of Appeals in No. 16,229	13a
Appendix F	
Order of the Court of Appeals Denying Petition for Rehearing in Nos. 16,154 and 16,155	14a

CITATIONS

Cases:

Aiken Drive-In Theatre Corp. v. United States, 281 F.2d 7 (4th Cir. 1960)	5
Commissioner v. Gross, 236 F.2d 612 (2d Cir. 1956)	7
Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943)	7

PAGE

Spicer Theatre, Inc. v. Commissioner, 346 F.2d 704 (6th Cir. 1965) 5

Whipple v. Commissioner, 373 U.S. 193 (1963) 7, 9

Statutes:

Internal Revenue Code of 1954

Section 61 5

Section 482 ..... 2-3, 5, 6, 10

Miscellaneous:

Plumb and Kapp, "Reallocation of Income and Deductions under Section 482," 41 *Taxes* 809 (December, 1963) 10

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

PAULINE W. ACH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF ERNEST M. ACH, DECEASED, PAULINE W. ACH, SOLE LEGATEE, AND PAULINE W. ACH, SURVIVING WIFE,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners, Pauline W. Ach and Estate of Ernest M. Ach, Deceased, Pauline W. Ach, Sole Legatee, and Pauline W. Ach, Surviving Wife, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit in its case Nos. 16,154 and 16,155.

OPINIONS BELOW

The opinion of the Tax Court is reported at 42 T.C. 114 and is printed at page 87a of the Appendix to Petitioners'

Brief.[1] The opinion of the court of appeals is reported at 358 F.2d 342 and appears at Appendix A hereto, page 1a, *infra*.

JURISDICTION

The judgment of the court of appeals in its case Nos. 16,154 and 16,155 was entered on March 30, 1966. Appendix B and C hereto, pages 10a and 11a, *infra*. Its judgment in Nos. 16,156 and 16,229, decided on the same record from the Tax Court, also was entered on March 30, 1966. Appendix D and E hereto, pages 12a and 13a, *infra*. Petitioners' timely application for rehearing in Nos. 16,154 and 16,155 was denied on May 4, 1966. Appendix F hereto, page 14a, *infra*. The jurisdiction of this Court is invoked under 28 U.S.C. section 1254(1).

QUESTION PRESENTED

Petitioner, Pauline W. Ach, sold a dress business which she had operated for several years as a sole proprietorship at net book value to a valid and subsisting family corporation. After the sale Pauline rendered managerial services to the corporation without compensation and engaged in no other business endeavor. The question presented is whether the Commissioner of Internal Revenue is empowered under section 482 of the Internal Revenue Code of 1954 to allocate gross income of the corporation to Pauline W. Ach as the corporation's managing employee under the theory that she was a separate organization, trade, or business.

STATUTE INVOLVED

Section 482 of the Internal Revenue Code of 1954:

---

[1] Nine copies of the Appendix printed for use in the court of appeals have been filed with the Clerk of this Court pursuant to Rule 21(4).

"In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

STATEMENT

Pauline W. Ach and her husband, Ernest M. Ach, had two sons, Roger W. Ach and S. Laurence Ach. Ernest died on February 14, 1956. (R. 88a-89a)

In December, 1946, Roger and his father formed a corporation (The Ach Corporation), and they transferred to it the assets of a dairy business which they had purchased earlier. Roger owned the entire 300 issued and outstanding common shares of the corporation until July 14, 1953, at which time he gave 149 of these shares to his brother Laurence. (R. 89a-92a)

Throughout the years 1947 through 1952 the corporation's principal business was operating a creamery plant. Roger was president of the corporation and was its chief executive officer. Ernest and Pauline did not participate in the management of the corporation during these years, but Ernest did make loans to the corporation totaling $282,700.00, evidenced by interest bearing notes. The dairy business was unsuccessful and was discontinued by the corporation prior to August 1, 1953. (R. 89a-90a)

For approximately 29 years prior to 1953 Pauline had owned and operated as a sole proprietorship a successful retail dress and apparel business known as Vogues and Vanities. Vogues and Vanities employed nine to twelve

persons, and the net book value of its assets on August 1, 1953, was $30,705.57. (R. 92a)

At that time, Pauline sold the business of Vogues and Vanities for $30,705.57 to the corporation which gave its note for $30,705.57 to Pauline in payment. That note was subsequently paid in full by the corporation prior to August 12, 1954. The Tax Court found concerning this sale that "the corporation was actually in existence and there was a genuine transfer of assets to it that were actually used in the conduct of the dress business." (R. 93a-94a, 97a, 101a).

Contemporaneously, Pauline became a director and president and treasurer of the corporation and continued as such during the taxable years in controversy. During this same period Pauline managed the dress business on behalf of the corporation and did not engage, either as a sole proprietor or otherwise, in any other business endeavor. Pauline received no payments from the corporation which were designated as compensation for her services as manager of the corporation. (R. 93a-94a)

After 1953 the corporation made payments on the notes held by Ernest, first to him until his death in 1956, then to his estate until it was closed in 1958, and finally to Pauline. (R. 79a, 95a)

During the taxable years in question the corporation received and reported the income derived from the dress business, and Pauline W. Ach did not reflect or report the receipt of any income arising out of her management of the dress business. The payments made by the corporation on account of the notes held by Ernest M. Ach, his estate, and ultimately by Pauline, were properly reflected by the corporation as reducing the principal amount due on such notes.

The Commissioner of Internal Revenue issued a statutory notice of deficiency in which he determined that the entire net income of the corporation was allocable to

Pauline under section 482, and includable in her gross income under section 61. (R. 6a, 16a)

The Tax Court, based on its estimate of corporate profits attributable to Pauline's services, found that seventy per cent of such profits were allocable to Pauline under section 482 and thus includable in her gross income. At the same time it rejected the Commissioner's contention that the corporation was a sham and that the transfer of Vogues and Vanities to the corporation lacked substance. The jurisdiction of the Tax Court was invoked under the applicable provisions of the Internal Revenue Code of 1954.

The court of appeals affirmed the decision of the Tax Court.

SPECIFICATION OF ERRORS TO BE URGED

The courts below erred in holding that an individual whose only business endeavor is managing the business of a corporation is a separate organization, trade, or business within the meaning of section 482 of the Internal Revenue Code of 1954.

REASONS FOR GRANTING THE WRIT

1. The decision of the court of appeals presents an important and novel question of federal income tax law which has not been, but should be, settled by this Court. Section 482 gives to the Commissioner unusually broad powers to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among controlled organizations, trades, or businesses. Moreover, it is now well established that once the Commissioner has acted under section 482, his determination will stand unless the taxpayer proves it is arbitrary. *Aiken Drive-In Theatre Corp.* v. *United States*, 281 F.2d 7 (4th Cir. 1960); *Spicer Theatre, Inc.* v. *Commissioner*, 346 F.2d 704 (6th Cir. 1965). Or, as the Tax Court stated in this case:

> "The Commissioner has considerable discretion in applying this section and his determination must be sustained unless he has abused his discretion. We may reverse his determinations only where the taxpayer proves them to be unreasonable, arbitrary or capricious." 42 T.C., at 125-26.

Because of the broad and sweeping authority which the Commissioner may exercise under section 482 in allocating income and deductions from one taxpayer to another, and because of the heavy burden placed upon the taxpayer in resisting such an allocation, it is of the utmost importance that the scope and extent of the Commissioner's authority be carefully delineated to prevent the application of that section to taxpayers and to transactions which are not clearly within its terms.

The question presented is important further because of its application to countless numbers of taxpayers who have elected to do business in the corporate form. The Tax Court and the court of appeals in this case have held that an individual, who is not engaged in any business endeavor other than managing the business of a corporation, is an organization, trade, or business separate and apart from the corporation by which he is employed. Thus, if the courts below correctly interpret the law, the Commissioner may allocate gross income and deductions of a corporation to its controlling shareholders in any case where the shareholders' services contribute to the corporation's profits.

The decisions of the courts below significantly diminish the advantages of incorporation under the Internal Revenue Code for the small closely held corporation. The Commissioner may now contend, and under these decisions he will be sustained, that a controlling shareholder who has elected not to demand from the corporation a salary commensurate with the value of his services is taxable on the income generated by his services.

2. The decision of the court of appeals presents a conflict, in principle, with decisions of this Court and other courts of appeal. In *Whipple* v. *Commissioner*, 373 U.S. 193 (1963), this Court held that an individual shareholder who was actively engaged in serving his own corporation was not in a trade or business and therefore could not deduct as business bad debts advances made by him to the corporation of which he was a shareholder. The Court, relying on several of its prior decisions, stated: "Devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged." 373 U.S., at 202.

In the instant case it has been stipulated by the parties, and the trial court has found accordingly, that Pauline W. Ach did not engage, either as a sole proprietor or otherwise, in any business endeavor other than managing the dress business of The Ach Corporation. On these facts and findings the conclusion that Pauline W. Ach is an organization, trade, or business cannot be reconciled with the decision of this Court in *Whipple* v. *Commissioner*, *supra*.

This case also presents a conflict, in principle, with *Commissioner* v. *Gross*, 236 F.2d 612 (2d Cir. 1956), where the court stated:

> "The officers of a corporation are not compelled to take salaries for the services they render. They may donate their services to the corporation if they choose to do so." 236 F.2d, at 618.

Finally, in *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943), this Court laid down the following rule:

> "The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undis-

closed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. . . ." 319 U.S., at 438-39.

The decision below is in violation of this established principle of corporate and tax law inasmuch as it holds that the corporate entity may be ignored in any case where controlling shareholders contribute to the realization of profits by a corporation, and that in such a case the profits may be taxed directly to the shareholders.

3. The decision of the court below is believed to be an erroneous application and interpretation of the law and such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. Fair and impartial administration of the tax laws requires that the words of the statute imposing the tax be given their usual and customary meaning. The judicial power should not be employed to countenance an arbitrary extension of the application of the statute to encompass taxpayers and transactions clearly not within its terms. In this case the language of the statute is plain and unambiguous in providing that the Commissioner may only allocate gross income between "*two or more* organizations, trades, or businesses." (Emphasis added.) An application of the statute where there is but one organization, trade, or business is thus in flagrant disregard of its terms and should be corrected.

The Tax Court and the court of appeals have applied the statute in such a manner as to subvert completely the requirement that there be two or more organizations, trades, or businesses before the Commissioner can act; and they have done this without a single precedent to support their position and in spite of substantial authorities

suggesting a contrary result. For the simple and obvious fact is that there is here only one organization, trade, or business, namely, a dress business, and all of its assets are owned by The Ach Corporation. The holding that Pauline W. Ach was a second organization, trade, or business is refuted by the applicable findings of fact of the trial court that:

> (1) Pauline W. Ach made a genuine transfer of all the tangible assets of the dress business to The Ach Corporation which were thereafter actually used by The Ach Corporation in the conduct of the dress business.
>
> (2) Pauline W. Ach did not engage either as a sole proprietor or otherwise in any business endeavor other than management of the dress business.

Thus Pauline W. Ach did not operate as a sole proprietorship in any of the taxable years involved; she owned no assets used in a trade or business; and she had no employees. According to the Tax Court her only business endeavor was managing the dress business which she had sold to The Ach Corporation. We have, therefore, only one organization, trade, or business, that of The Ach Corporation, and this one organization, trade, or business was managed by Pauline W. Ach. *Cf. Whipple* v. *Commissioner, supra.* To hold on these facts that Pauline W. Ach was an organization, trade, or business separate from the corporation she managed necessitates a strained construction of the plain language of the statute and would mean that a single organization, trade, or business could be fragmented for tax purposes into as many organizations, trade, or businesses as it had managers or employees, thus subjecting to the Commissioner's authority to allocate income or deductions a vast new area of transactions and relationships.

While section 482 may present difficult questions of interpretation in other contexts, there can be no disagreement that section 482 presupposes an allocation from one organization, trade, or business to another co-existing, separate organization, trade, or business, related through common ownership or control.[2] The Tax Court and court of appeals have misinterpreted and misapplied section 482 in allocating the income of a single organization, trade, or business to one of its constituent parts, namely, its managing employee.

CONCLUSION

For the foregoing reasons, petitioners pray that a writ of certiorari issue to review the decision of the Court of Appeals for the Sixth Circuit.

Respectfully submitted,

H. J. SIEBENTHALER
2300 Central Trust Tower
Cincinnati, Ohio 45202
Attorney for Petitioners

WILLIAM R. SEAMAN

RONALD E. HEINLEN

FROST & JACOBS
2300 Central Trust Tower
Cincinnati, Ohio 45202

July, 1966

---

[2] *Cf.* Plumb and Kapp, "Reallocation of Income and Deductions under Section 482," 41 *Taxes* 809, 810 (December, 1963):

> "It is doubtful that Section 482 applies to dealings between a corporation and an individual stockholder, other than in his capacity of carrying on an individual business. . . ."

APPENDIX A

No. 16154

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PAULINE W. ACH, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 16155

ESTATE OF ERNEST M. ACH, DECEASED, PAULINE W. ACH, SOLE LEGATEE, AND PAULINE W. ACH, SURVIVING WIFE, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 16156

THE ACH CORPORATION, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 16229

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*

v.

THE ACH CORPORATION, *Respondent.*

On Petitions to Review Decisions of the Tax Court of the United States

---

Decided March 30, 1966.

Appendix A

Before: WEICK, Chief Judge, CELEBREZZE, Circuit Judge, and CECIL, Senior Circuit Judge.

CECIL, Senior Circuit Judge. These cases are before the Court on petitions for review of decisions of the Tax Court of the United States. The petitioners and taxpayers are: Pauline W. Ach in docket No. 16,154, Estate of Ernest M. Ach, deceased, Pauline W. Ach, sole legatee and Pauline W. Ach, surviving wife in docket No. 16,155 and the Ach Corporation in docket No. 16,156. The Commissioner of Internal Revenue, respondent herein, determined deficiencies in income tax against the above named taxpayers and they brought actions in the Tax Court for redetermination of those deficiencies.

The claimed deficiencies grow out of the inter-related dealings between Ernest M. Ach, his wife, Pauline W. Ach, and their two sons, Roger and Laurence. These dealings disclose a family plan the obvious purpose of which was to avoid or minimize the income tax of the husband and wife. It is perfectly proper for individuals and corporations to arrange their business affairs so as to minimize taxes and in the cases now before us the transactions were open and above board and no fraud is claimed. The question presented here is whether the transactions involved came within any statutory prohibitions of the Internal Revenue Code.

The facts are fully stated in the Findings of Facts and Opinion of the Tax Court reported at 42 T.C. 114. Briefly stated, the pertinent facts of the family transactions may be summarized as follows: Prior to and through mid 1953, the son Roger owned all of the stock (300 shares) of Rising Sun Creamery Company, an Ohio Corporation. The stated purpose of the corporation was to deal in dairy products. Roger had operated the business at a substantial

loss each year and at the end of the year 1953, the cumulative indebtedness amounted to $282,700. This indebtedness was evidenced by notes with interest payable to Ernest Ach, the father, who had covered the yearly losses.

At the time now under consideration and for a number of years prior thereto, Pauline operated a dress shop in Cincinnati under the name of Vogues and Vanities. This was, and had been, a successful business, netting profits of $25,000 to $30,000, a year, with the indication that profits were rising.

On April 23, 1953, the corporation changed its name to the Ach Corporation. It also changed its stated corporation purposes from a dairy products business to broad, general purposes which would include the operation of the dress business of Vogues and Vanities. The dairy business was discontinued prior to August 1, 1953. On or about July 14, 1953, Roger, pursuant to his parents' suggestion, transferred to his brother Laurence, without consideration, 149 shares of the corporation's common stock. All of the shares of the Corporation were transferred to Pauline by Roger and Laurence, without consideration, in May 1959. At this time the corporation's net operating loss was no longer available as a carry over against income.

On or about August 1, 1953, Pauline became president, treasurer, and chairman of the board of directors of the Ach Corporation. She was not then a shareholder of record. On that date, at a special meeting of the Board of Directors, she offered to sell to the Corporation her Vogues and Vanities business for $30,705.57, to be paid for by a demand note of the Corporation without interest. The agreed purchase price was the book value of the business. The offer was accepted and the transfer was made.

Pauline continued to manage the business under the name of Vogues and Vanities. There was no ostensible change in the conduct of the business. Pauline received no salary from either the business or the corporation. Roger and Laurence, the sole shareholders of the corporation, were engaged in other business ventures not related to the dress business. They took no active part in the operation of Vogues and Vanities. The profits of the business, under Pauline's continued management, were channeled through the corporation and were used first to pay to Pauline the purchase price of the business as evidenced by the corporation's demand note to her and second to pay the corporation's notes to Ernest. The profits thus realized by the corporation were offset against the carry over losses of the dairy business and no income tax was paid for the years in question.

The respondent took the position that the transfer should be disregarded as fiction and that all of the profits of Vogues and Vanities should be allocated to Pauline under Section 482, Title 26, U.S.C. He also ruled that the loss carry-over should be disallowed under Section 269, Title 26, U.S.C. The deficiencies were determined on this basis. The petitioners challenged these rulings and brought their actions in the Tax Court for a redetermination of the tax.

The Tax Court did not follow the respondent on the first ruling above mentioned. It found that, "The corporation was actually in existence, and there was a genuine transfer of assets to it that were actually used in the conduct of the dress business." While we might take a different view if this question were initially before us, we cannot say that this finding is clearly erroneous. Rule 52(a) F.R.C.P., *Commissioner* v. *Duberstein*, 363 U.S. 278.

Judge Raum of the Tax Court wrote a comprehensive opinion covering the issues raised by the petitioners in

that court. (42 T.C. 122) We are in accord with the opinion of Judge Raum and find no need to repeat the discussion of the issues before the Tax Court.

The petitioners argue before this Court that the amount of profits allocated to Pauline was not based on any intelligible method of calculating the income attributable to her and that the Court's decision was wholly arbitrary. We are of the opinion that there was ample evidence to support the decision of the Tax Court. Under the evidence, we think that the amount of profits allocated to Pauline was minimal and that it might well have been greater. In *Cohen* v. *Commissioner of Internal Revenue*, 266 F.2d 5, 12, C.A. 9, the court said:

> "We neither state nor imply that the Tax Court's redetermination must be predicated upon precisely established income and expense figures. Since Cohan v. Commissioner, 2 Cir., 39 F.2d 540, it has been the recognized rule that absolute certainty is not required. It is sufficient if the Tax Court makes as close an approximation as it reasonably can. The Tax Court's permissible leeway in this regard is the same as that which the Commissioner originally had."

In *Bodoglau* v. *Commissioner of Internal Revenue*, 230 F.2d 336, 340 C.A. 7, the court said:

> "It is the function of the trier of the fact to weigh all the elements properly considered in the valuation and to translate them into dollars and cents. (Citations omitted) Nor is it essential that there be testimony of the specific figure fixed by the Tax Court."

We conclude that the Tax Court properly allocated seventy per cent of the profits of Vogues and Vanities to Pauline W. Ach.

Another question before the Tax Court and now before us is whether the losses sustained by the corporation prior to 1953 in the operation of its creamery and dairy business may be deducted as a net operating loss deduction in the corporation's tax years 1955-1958. The corporation claimed the right to make these deductions from the profits derived from the operation of the dress business in 1953 and subsequent years.

The Tax Court sustained the respondent in disallowing these deductions. The Tax Court held that the deductions were properly denied under and by virtue of Section 269 (a) of the Revenue Code of 1954. The pertinent part of this section reads as follows:

> "If—(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation,
>
> * * *
>
> and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then the Secretary or his delegate may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation."

The petitioners claim that this statute is not applicable for the reason that Pauline was not the record owner of the stock. The Tax Court found that she was the beneficial owner of all of the stock and as such owner she was within the coverage of the statute.

That the transactions here involved were for the purpose of tax avoidance cannot be successfully controverted. If Pauline had become the record owner of the stock on August 1, 1953, at the time she became president, treasurer, and chairman of the board of directors of the corporation, there could be no question about the application of the statute.

We consider first whether Pauline was the beneficial owner of the stock. This is a question of fact and we are of the opinion that there was ample evidence to support the finding of the Tax Court that she was in fact the beneficial owner of all of the stock of the corporation.

On or about July 14, 1953, Roger, the sole owner of all of the stock of the Ach Corporation, transferred 149 shares of the 300 shares to his brother Laurence. This transfer was made pursuant to the parents' suggestion, without consideration. Laurence had had nothing to do with the business of the corporation prior thereto and had nothing to do thereafter with the dress shop business, operated through the corporation, except to serve as a director. On August 1, 1953, Pauline became president, treasurer, and chairman of the board of directors of the Ach Corporation. On the same day she offered to sell her business to the corporation for its book value. She took in payment the demand note of the corporation, which had no assets except some land which was a remnant of the dairy business. It was hopelessly insolvent by reason of liabilities in the form of notes payable to her husband. There was no ostensible change in the operation of the dress business and Pauline continued in full control and management of the dress shop without any assistance from her sons, the record shareholders. Finally, about one year later, she paid herself the sale price of the business out of the profits of the business

earned through her management. Then when the corporation had served its purpose as a vehicle of tax avoidance, the sons transferred to their mother, at her request, all of the stock of the corporation.

This was indeed a thinly veiled transaction. It would be difficult to conceive of a more perfect example of control and beneficial ownership being in one person. There was no apparent reason for the transfer of the business of Vogues and Vanities to the corporation, other than tax avoidance. There was some testimony on behalf of the petitioners tending to show other purposes, but this was discredited, and we think justifiably so, by the trier of the facts. We cannot accept petitioners' claim that the Tax Court confused ownership of property with management of property. Each case must be judged upon its own facts. The cases [1] cited in petitioners' brief can be distinguished on their facts from the case at bar.

The Tax Court, having found that beneficial ownership of the stock was in Pauline, held that the word "ownership" in Section 269, above quoted, included beneficial ownership. We agree. The essential thrust of this statute is to prevent sham or fictitious transactions for the purpose of avoiding the payment of income taxes. Control is defined as stock ownership with 50 per cent of the voting power of a corporation. We understand this to mean the quantum of voting power necessary for control, not necessarily literal record ownership.

In the case before us where willing and obedient sons transferred the record title of shares pursuant to the suggestions and requests of their parents, we conclude that

---

[1] *Montgomery* v. *Commissioner*, 230 F.2d 472, C.A. 5; *Lawton* v. *Commissioner*, 164 F.2d 380, C.A. 6; *Henson* v. *Commissioner*, 174 F. 2d 846, C.A. 5; *Apt* v. *Birmingham*, 89 F. Supp. 361.

Appendix A

Pauline had one hundred per cent control of the corporation.

The Tax Court was correct in disallowing the carry over of the net operating losses against the profits of Vogues and Vanities.

The judgment of the Tax Court is in all respects affirmed.

Since this Court affirms the Tax Court in its allocation of income between Pauline and the corporation the cross-appeal of the respondent in docket No. 16,229 is moot and it is hereby dismissed.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 16,154

PAULINE W. ACH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition to Review a Decision of the Tax Court of the United States

---

Before: WEICK, Chief Judge, CELEBREZZE, Circuit Judge, and CECIL, Senior Circuit Judge.

This cause came to be heard on the transcript of record from the Tax Court of the United States and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

No costs awarded. Rule 23(4).

Entered by order of the Court.

/s/ CARL W. REUSS
Clerk

Filed: March 30, 1966

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 16,155

ESTATE OF ERNEST M. ACH, DECEASED, PAULINE W. ACH, SOLE LEGATEE, AND PAULINE W. ACH, SURVIVING WIFE,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition to Review a Decision of the Tax Court of the United States

---

Before: WEICK, Chief Judge, CELEBREZZE, Circuit Judge, and CECIL, Senior Circuit Judge.

This cause came to be heard on the transcript of record from the Tax Court of the United States and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

No costs awarded. Rule 23(4).

Entered by order of the Court.

/s/ CARL W. REUSS
Clerk

Filed: March 30, 1966

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 16,156

THE ACH CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition to Review a Decision of the Tax Court of the United States

---

Before: WEICK, Chief Judge, CELEBREZZE, Circuit Judge, and CECIL, Senior Circuit Judge.

This cause came to be heard on the transcript of record from the Tax Court of the United States and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

No costs awarded. Rule 23(4).

Entered by order of the Court.

/s/ CARL W. REUSS
Clerk

Filed: March 30, 1966

APPENDIX E

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 16,229

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

THE ACH CORPORATION,

Respondent.

On Petition to Review a Decision of the Tax Court of the United States

---

Before: WEICK, Chief Judge, CELEBREZZE, Circuit Judge, and CECIL, Senior Circuit Judge.

This cause came to be heard on the transcript of record from the Tax Court of the United States and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

No costs awarded. Rule 23(4).

Entered by order of the Court.

/s/ CARL W. REUSS
Clerk

Filed: March 30, 1966

Appendix F

APPENDIX F

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 16,154

PAULINE W. ACH,

Petitioner on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

No. 16,155

ESTATE OF ERNEST M. ACH, DECEASED, PAULINE W. ACH, SOLE LEGATEE, AND PAULINE W. ACH, SURVIVING WIFE,

Petitioners on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

No. 16,156

THE ACH CORPORATION,

Petitioner on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

Appendix F

ORDER

Before: WEICK, Chief Judge, CELEBREZZE, Circuit Judge, and CECIL, Senior Circuit Judge.

These causes are before the Court on a petition for rehearing of the appeal decided by us in our opinion of March 30, 1966. The petition seeks to limit the rehearing to the question of whether Pauline W. Ach, an individual, is an "organization, trade, or business" within the meaning of section 482 of the Internal Revenue Code.

That question was discussed and decided by the Tax Court in its opinion reported at 42 T.C. 114 at pages 124 and 125. We said at page 4 of our opinion.

> "Judge Raum of the Tax Court wrote a comprehensive opinion covering the issues raised by the petitioners in that court. (42 T.C. 122) We are in accord with the opinion of Judge Raum and find no need to repeat the discussion of the issues before the Tax Court."

Upon consideration of the petition for rehearing it is ordered that it be and is hereby denied.

Entered by order of the court.

/s/ CARL W. REUSS
Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE ACH CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in this case, but only if the Court grants the petition for a writ of certiorari filed by Pauline W. Ach, *et al.*, in a companion case, No. 396, this Term.

OPINIONS BELOW

The opinion of the Tax Court (R. 87a–110a)[1] is reported at 42 T.C. 114. The opinion of the court of appeals is reported at 358 F. 2d 342.[2]

[1] "R." references are to the appendix to the taxpayers' brief in the court of appeals, nine copies of which have been filed with the petition in No. 396, this Term.

[2] The opinion and judgment of the court of appeals in this case are reprinted as Appendix A, pp. 1a–9a, and Appendix E, p. 13a, to the petition in No. 396.

228-488—66

JURISDICTION

The judgment of the court of appeals was entered on March 30, 1966. By order dated June 21, 1966, Mr. Justice Stewart extended the time for filing a petition for certiorari to and including August 17, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Commissioner correctly reallocated and taxed income, initially reported by a corporation, to the individual who generated it.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 482. ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS
>
> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(26 U.S.C. (1958 ed.) 482.)

STATEMENT AND REASONS FOR GRANTNG THE WRIT

The facts are fully set forth in the petition for certiorari filed in the companion case, No. 396, this Term, and in the court of appeals opinion which is printed as an appendix to that petition (Pet. in No. 396, pp. 3–5, 1a–9a). The question presented by the cases (which were consolidated in the lower courts) is whether the income earned by a certain business is taxable to the Ach Corporation (the taxpayer in this case) or to Pauline W. Ach (one of the petitioners in No. 396) or in part to each. The Tax Court found, *inter alia,* that the income in question was taxable 30 percent to the Ach Corporation and 70 percent to Pauline W. Ach. The court of appeals affirmed on this issue. We agree with this determination and intend to oppose the petition for certiorari in No. 396. If, however, the Court should grant Pauline W. Ach's petition for certiorari in No. 396 and thereafter hold that less than 70 percent of the income was taxable to her, the amount taxable to the Ach Corporation would be correspondingly increased. Therefore, we are filing the instant petition for certiorari to protect the revenue if the Court should grant certiorari in No. 396.

CONCLUSION

If the petition for certiorari in No. 396, this Term, is granted, this petition should also be granted. Otherwise it should be denied.

Respectfully submitted,

THURGOOD MARSHALL,
Solicitor General.

RICHARD C. PUGH,
Acting Assistant Attorney General.

HAROLD C. WILKENFELD,
WILLIAM A. FRIEDLANDER,
Attorneys.

AUGUST, 1966.

U.S. GOVERNMENT PRINTING OFFICE: 1966

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 396

PAULINE W. ACH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ESTATE OF ERNEST H. ACH, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

This case involves the scope of the Commissioner's statutory power under 1954 Code § 482 to reallocate income between entities which are under common control. Section 482 provides:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income,

230-439—66

deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

Prior to August 1953, Pauline Ach owned and operated, as an individual, a successful dress shop, earning approximately $30,000 per year. Her two sons were the sole stockholders of a corporation which had previously engaged unsuccessfully in the operation of a dairy business but which, having accumulated substantial net operating losses, had discontinued that business and was inactive and insolvent. The corporation owed a large sum to Ernest Ach, the father of the corporation's stockholders and Pauline's husband. Because of the hopeless financial condition of the inactive corporation, this debt was uncollectible.

On August 1, 1953, Pauline transferred to the corporation certain assets of her dress business in exchange for a non-interest-bearing note for $30,705, which was the assets' book value. She did not, however, transfer to the corporation certain intangible assets—the right to use her name or the name under which she had operated the business, the right to her managerial services, the goodwill attendant upon her identification with and operation of the business, etc.—which the Tax Court found to be the most important and valuable aspects of the business. Thereafter, Pauline continued to manage and operate the dress shop in the same manner as before. Although

the corporation purported to pay her no salary, it did, over the five years here in question (1954–1958), pay Pauline and her husband the bulk of the profits from the dress business, allegedly on account of the corporation's debts to them. And in mid-1959 Pauline's sons transferred to her all of the corporation's stock without further consideration.[1] (Pet. 1a–9a, R. 101a.)

On her tax returns for those years, Pauline reported no income from her activities in connection with the dress business; the corporation reported the profits of the dress business but used the net operating losses previously incurred in the dairy business to wipe out any liability for taxes. The Commissioner took alternative positions, claiming, first, that the net income of the dress business should be reallocated to Pauline under 1954 Code § 482, and, second, that to the extent the income was taxable to the corporation, its claimed net operating loss carry-forward should be denied.

In the Tax Court, petitioners challenged the applicability of § 482 on the ground that Pauline, following the transfer of the physical assets of her dress business to the corporation, was no longer engaged in a "business" and that she did not, therefore, constitute an independent "organization," "trade," or "business" to which income might be reallocated under § 482. The Tax Court found that the most valuable income-earning aspects of the business—the

[1] The lower courts found that Pauline had actually acquired beneficial ownership to the corporation's stock at the time she transferred the assets of her dress business to the corporation in August 1953.

intangible assets—had been retained by Pauline, and that her continued activity constituted a "business." It determined that 30 percent of the business income was attributable to the assets owned by the corporation and the balance to the aspects of the business which remained with Pauline; it therefore held that 70 percent of the income was taxable to Pauline and 30 percent to the corporation.[2] The court of appeals affirmed.[3] (R. 99a–110a, Pet 1a–9a.)

---

[2] The Tax Court stated (R. 101a):

> Plainly, [the transfer of assets by Pauline to the corporation] was not an arm's length transaction. The corporation was hopelessly insolvent, and it is utterly beyond belief that any unrelated third party would have sold a prosperous business for a non-interest bearing $30,705.57 note of such an insolvent maker where the level of earnings of that business was about $30,000 a year and rising, and where the seller contemplated continued full-time management of the business without compensation. Notwithstanding testimony indicating otherwise, it is all too clear to us on this record that Pauline was acquiring control of this moribund corporation for the purpose of attempting to utilize the net operating loss carryover of the dairy business, to offset the resulting deductions against earnings of her successful dress business and to obtain the actual benefits of those tax-free earnings by having the corporation pay off, first, her $30,705.57 note, and then the notes of some $280,000 held by her husband which were otherwise uncollectable—all of which would be received free of tax!

[3] The lower courts also sustained the Commissioner's alternative position that 1954 Code § 269 prevented the corporation from carrying forward its previous net operating losses from the discontinued dairy business, and thus that the corporation was taxable on the 30 percent of the dress business income which was allocable to it. The corporation has not filed a petition for a writ of certiorari and the lower courts' determination on that issue is now final.

The decisions of the lower courts were correct. There is no conflict of decisions or other ground warranting further review. . .

1. Petitioners argue that Pauline's activities were not sufficient to constitute a "business" and that the Commissioner was thus precluded from reallocating income to her under § 482. The Tax Court found that Pauline's retention of the intangible assets and her use of them in the continuing operation amounted to a "business." Whether a particular taxpayer's activities are sufficient to constitute a trade or business within the meaning of the Code depends principally on the facts of each case, and the question is not readily susceptible to a rule of general applicability. Moreover, this Court has reviewed several cases involving this question under other sections of the Code,[4] and there is no present need for the Court to review this question in the context of the particular facts of the case at bar.[5]

2. There is no conflict between the instant decision and the cases cited by petitioners (Pet. 7–8). In *Whipple* v. *Commissioner, infra,* this Court held only that "[d]evoting one's time and energies to the af-

[4] See, *e.g.*, *Whipple* v. *Commissioner*, 373 U.S. 193; *Burnet* v. *Clark*, 287 U.S. 410; *Higgins* v. *Commissioner*, 312 U.S. 212; see also *Folker* v. *Johnson*, 230 F. 2d 906 (C.A. 2); *Schmidlapp* v. *Commissioner*, 96 F. 2d 680 (C.A. 2); *Noland* v. *Commissioner*, 269 F. 2d 108 (C.A. 4).

[5] Since, as the Tax Court found, Pauline had retained valuable intangible assets, petitioners are incorrect in asserting (Pet. 6) that the instant decision will apply to any case where "a controlling shareholder * * * has elected not to demand from the corporation a salary commensurate with the value of his service."

fairs of a corporation is not of itself, and without more, a trade or business of the person so engaged" (p. 202). However, the Court recognized that if additional facts were present, a court might be justified in holding that the shareholder-employee was engaged in a trade or business (pp. 203–205).

Nor does the instant decision conflict with *Commissioner* v. *Gross*, 236 F. 2d 612 (C.A. 2), since that case involved only 1954 Code § 61. The Commissioner did not there attempt to invoke, and the courts thus did not consider, the special remedial provisions of § 482, the provision here in question. Cf. *Tennessee-Arkansas Gravel Co.* v. *Commissioner*, 112 F. 2d 508, 510 (C.A. 6).[6]

Finally, *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436, is entirely inapposite since the lower courts did not refuse to treat the corporation as a separate taxable entity. On the contrary, the Tax Court found there was a genuine transfer of tangible assets to the corporation and that the portion of the dress business' income properly attributable to those assets (30 percent) should be taxed to the corporation (R. 101a–102a, 106a).

---

[6] In *Tennessee-Arkansas* the taxpayer corporation rented property to a related corporation but did not collect any rent. The Commissioner attempted to tax the lessor corporation on rental income without giving the lessee corporation a corresponding deduction for rent paid. The court held that the Commissioner may not create income in this manner, but suggested that the Commissioner might (as he has done in the instant case) use § 482 or its predecessor to reallocate some of the reported income from one related taxpayer to another.

Therefore, the petition for a writ of certiorari should be denied.

Respectfully submitted.

THURGOOD MARSHALL,
Solicitor General.
RICHARD C. PUGH,
Acting Assistant Attorney General.
HAROLD C. WILKENFELD,
WILLIAM A. FRIEDLANDER,
Attorneys.

SEPTEMBER 1966.

U.S. GOVERNMENT PRINTING OFFICE: 1966

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
OCT 6 1966
JOHN F. DAVIS, CLERK

No. 396

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

PAULINE W. ACH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF ERNEST M. ACH, DECEASED,
PAULINE W. ACH, SOLE LEGATEE, AND
PAULINE W. ACH, SURVIVING WIFE,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION

H. J. Siebenthaler,
2300 Central Trust Tower,
Cincinnati, Ohio, 45202,
Attorney for Petitioners.

William R. Seaman,

Ronald E. Heinlen,

Frost & Jacobs,
2300 Central Trust Tower,
Cincinnati, Ohio, 45202.

October, 1966

The Johnson & Hardin Co., Law Printers
Cincinnati, Ohio

No. 396

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

PAULINE W. ACH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF ERNEST M. ACH, DECEASED,
PAULINE W. ACH, SOLE LEGATEE, AND
PAULINE W. ACH, SURVIVING WIFE,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY TO RESPONDENT'S MEMORANDUM IN OPPOSITION

Respondent would have this Court deny certiorari in this case on the ground that "whether a particular taxpayer's activities are sufficient to constitute a trade or business within the meaning of the Code depends principally on the facts of each case, and the question is not readily susceptible to a rule of general applicability." (Resp. Memorandum, p. 5)

The question presented by the petition, however, is not basically a factual one. We are not asking this Court to review, weigh, and appraise a multiplicity of factual details which might or might not sustain a finding that an individual is engaged in a trade or business. Rather, the question submitted to this Court is whether an individual, whose only business endeavor is managing the business of a corporation, is an organization, trade, or business separate and apart from that corporation.[1]

Respondent relies on Mrs. Ach's alleged retention of intangible assets as sufficient to justify a holding that she was a "business," thus presenting a legal question that is novel and unique in the field of federal taxation. Diligent search by counsel for petitioners has disclosed no authority in support of any such proposition, and neither respondent nor the Tax Court has offered any support for it.[2]

There is no contention that Mrs. Ach utilized the intangibles allegedly retained in any manner in the conduct of a business separate from that of The Ach Corporation; and while Mrs. Ach did not enter into a contract of employment with the corporation, and did not agree to refrain from competition with the corporation, the facts are that she did work for the corporation and did not compete. Similarly, the valuable trade name "Vogues and Vanities"

---

[1] Respondent has stipulated, and the Tax Court found as a fact, that Mrs. Ach did not engage either as a sole proprietor or otherwise in any business endeavor other than management of the dress business during the taxable years in controversy. (R. 48a, 94a)

[2] The Record contains no evidence to support the conclusion that Mrs. Ach retained title to any intangible elements of the dress business and the Tax Court did not find that to be a fact. The statement in the Tax Court's opinion on this point (R. 103a-104a) is contrary to the evidence, including the Stipulation of Facts, and to the Tax Court's own findings of fact. It is also highly dubious legally that any such "intangibles" could exist in a former proprietor after the transfer of the business to a corporation which actually carried on the business.

was never used by Mrs. Ach in a separate business endeavor, but was actually used by the corporation and the Tax Court so found as a fact. (R. 94a)

The Tax Court has thus held that the mere fact that Mrs. Ach *could* have entered into a trade or business separate from that of the corporation, is sufficient to make her a trade or business for the purpose of section 482 of the Internal Revenue Code. This holding significantly extends the scope of section 482 and permits the Commissioner to allocate gross income and deductions in cases where there is in actuality only a single organization, trade, or business.

Thus, contrary to respondent's assertions, it is apparent that the legal issue raised by the petition in this case is one of prime importance in the law of federal income taxation. The impact of the decision below will extend to cases arising under numerous other sections of the Internal Revenue Code where the question is whether the taxpayer is engaged in a trade or business. For these reasons, petitioners believe that a writ of certiorari should issue to review the decision of the Court of Appeals for the Sixth Circuit.

Respectfully submitted,

H. J. SIEBENTHALER,
2300 Central Trust Tower,
Cincinnati, Ohio, 45202,
Attorney for Petitioners.

WILLIAM R. SEAMAN,

RONALD E. HEINLEN,

FROST & JACOBS,
2300 Central Trust Tower,
Cincinnati, Ohio, 45202.

October, 1966.